



Min-it Software



Joint Submission –

**TREASURY Consultation –
Enhancements to Unfair Contract Term Protections**

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Background Information

This submission is made on behalf of the Financiers Association of Australia (“FAA”) and Min-it Software clients.

The Financiers Association of Australia (“FAA”) and Min-it Software (“Min-it”) welcomes the further opportunity to make this submission on Treasury’s consultation on extending unfair contract terms to small businesses.

The FAA, having been established since the 1930’s, is an organisation for individuals and companies involved in the fields of finance and credit provision. The FAA’s members are either non-ADI credit providers, providing loans up to \$5,000 over terms of up to 2 years, mortgage financiers or business financiers.

Aside from the software produced in-house, specifically by or for franchised organisations, Min-It Software is a leading loan management software supplier to the micro-lending sector of the Australian market. Additionally, it has a number of clients providing motor vehicle finance as well business loans and consumer leases.

The vast majority of Min-It’s clients are not affiliated with any industry association.

Introduction

As Treasury notes, consumer unfair contract terms (“UCT”) were extended to standard form small business contracts in late 2016 where the business met the relevant ‘small business’ criteria and allowed for some specific exemptions by the enactment of the Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015 (“SBUCT”).

The Explanatory Memorandum accompanying the Consultation Paper to the 2016 Act stated:

“The objective of this reform is to promote fairness in contractual dealings with small businesses with regard to standard form contracts. This will reduce small business detriment and have positive impacts on the broader economy by increasing small business certainty and confidence, and providing for a more efficient allocation of risk. Small businesses, in dealing with other businesses through standard form contracts, should have confidence that the contract they are offered is fair and reasonable and that the risks are allocated efficiently”.

At that time, we stated we were of the opinion these objectives would not be met and now, some 3 years down the track, there are areas where we are still of that opinion.

Most lawyers suggest it’s preferable to negotiate contract terms as in so doing, it leaves any commercial terms and some possible Unfair Contract Terms (“UCT”) in place. Typically, these would cover indemnities and guarantees as well as possible changes to the contract. Many small businesses, though, do not negotiate as they probably believe there’s no chance to negotiate whereas those with more experience know that some terms may be amended to better suit the agreement. This may be down to a reluctance to engage a solicitor for either time restraint or cost considerations or purely apathy. In doing attempting to negotiate the contract terms, it reinforces the business owner’s belief that they have no power to negotiate and that the standard contract is a “take it or leave it” proposition. If that’s the case, then these businesses should accept the standard form contract but aware it may ultimately cost them more.

Franchising

Whilst we will not respond specifically to the Franchise questions, we understand that the franchisor requires the franchisee to adhere to its business model with no deviation, possibly to protect itself. Examples of this exist in the finance area where:

1. brokers and lessors are required to use specific software platforms; and /or
2. are required to trade as a Credit Representative under the franchisor's Australian Credit Licence.

In the latter instance, we would question exactly what business the franchisee has bought or to sell when it wants to exit as invariably, the consumer's entire trading data is all held by the franchisor. The franchisor in such instances holds all the power.

One of the big issues facing franchisees that are typically small businesses by any definition is where the existing model changes due to current economic or regulatory requirements. The new model is essentially untested and so it cannot be ascertained it will produce the financial returns and ongoing viability the franchisor may previously had indicated possible in its Disclosure documentation. From purely a protection perspective, in such circumstances, if the franchisor cannot do so and the franchisee wants to continue business without the franchisor's backing, should the franchisee be able to recover its data and any UCT's relating to restrictions of trade or trade practises then be void? Most franchisors we know of that want to exit their franchise need to have the restriction of trade limitations lifted as a minimum. There is also the question of paying out the balance of any franchise fees for the remainder of the franchise term that needs to be examined. If the franchise cannot produce the financial returns claimed any more, then from a protection view, should these be open to reasonable negotiation rather than a full-on arms wrestle?

Buy now, pay later issue

Although unrelated to franchising, the Buy Now, Pay Later ("BNPL") providers that have clauses in their merchant agreement that restricts the merchant from applying a surcharge.

The Reserve Bank¹ released a consultation paper in late November 2019 on this very question. The “no surcharge” requirement is frequently enforced yet it creates a dichotomy between what applies to credit cards where the retailer can apply a levy but not on the BNPL transactions. As Nathan Huppatz said in an article on Smart Company², “merchants feel like they’re “over a barrel” – squeezed between high fees and a feeling they must use the popular services.” The reason these merchants can’t charge the surcharge is it would mean the BNPL provider may not be compliant under the s.6 (1) exemption it relies upon under the National Credit Code (“the Code”) and the surcharge may not be at cost so would breach the third party fees at cost requirement under s.32 of the Code.

¹ Reserve Bank of Australia, 2019. Review of Retail Payments Regulation: Issues paper, November 2019. Available online <https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/pdf/review-of-retail-payments-regulation-issues-paper-nov-2019.pdf> viewed 13 December 2019.

² SmartCompany, 2019. “*Over a barrel: Should Afterpay’s ‘no-surcharge’ rule for merchants be axed?*”, 2 December 2019. Available online https://www.smartcompany.com.au/finance/afterpay-surcharge-bnpl/?utm_campaign=SC&utm_medium=email&utm_source=newsletter&utm_content=smartco_daily&term=2019-12-02 viewed 13 December 2019

Thresholds

Discussion Question 3

Are you aware of any industries in which UCTs (or potential UCTs) are regularly included in standard form contracts? If so, please provide details including which industries, the types of UCTs (or potential UCTs) and the prevalence of UCTs (or potential UCTs).

We are very aware that finance contracts for both loans and leases do contain UCT's. For example, in a commercial leasing contract, the following clauses are UCT's or potential UCT's that appear in just this one contract:

1.4 The sole obligation of the owner is to pay the supplier of the equipment the purchase price of the equipment including any applicable licence fees.

Issue – the contract doesn't contain a reference or definition of "purchase price". All the contract contains is a field containing "Fixed Monthly Rental Payment".

Heading The guarantor has a primary obligation to pay the guaranteed money immediately upon demand.

Issue – this could be claimed at any time and not just when a payment has been missed or dishonoured.

16.1 Whenever the owner requests the client to do anything:

(c) for aiding the exercise of any right or power in any agreement, the client shall do it promptly. This may include obtaining consents, getting documents completed and signed, supplying information, delivering documents and evidence of title and executed blank transfers, and giving possession or control with respect to any property the subject of any security interest.

Issue – no lawyer would recommend giving executed blank transfers ever.

Heading **Issue** - This contract asks for Security Property in addition to the leased good and in

the event the Director(s) provide it, the Director(s) are required to enter into a Security Guarantee with the lessor. Most small businesses would interpret this as being their home. The contract already provides for the lease being a PPS lease and so provides adequate protection.

17.1 A certificate given by or on behalf of the owner regarding any amount owing by the client under this agreement or any interest rate referred to in this agreement is prima facie evidence of the matters certified

Issue – this was a UCT when Victoria first published its list of UCT's.

Despite the above, when a lessee wants to buy the item off the lessor, the lessor produces a Purchase Agreement where it becomes the buyer and the lessee is the seller. The contract contains the usual provision that the lessee cannot “sell, dispose of, encumber, part with possession of or otherwise deal with the equipment without the written consent of the owner”. Under Clause 6 of this Agreement, “Ownership of and risk in the Equipment passes from the Seller to the Buyer on payment of its Purchase Price (without the need for physical delivery to the Buyer and notwithstanding the Equipment remains in the possession of the Seller or a third party) and under clause 8 (b), “the Seller is the owner of and has full legal and beneficial title to all the Equipment free of Encumbrances other than those approved by the Buyer”. The Purchase Agreement is therefore in complete violation of the contract.

In our view, although not strictly a UCT in its own right, when viewed in totality of the original contract, it ought to be. Whilst it could be argued this is poor legal drafting, it places the lessee in a difficult position if it accepts the Agreement at face value.

Discussion Question 4

As a small business, have you accepted, or would you be willing to accept, a potential UCT in a standard form contract? If so, provide details including, reasons for doing so and any impacts on your business. Please do not include business names.

We and our clients and members have indicated they would be willing to accept a UCT but it would depend entirely on the totality of the contract and what the UCT covers.

Discussion Question 5

Do you have any suggestion as to how regulatory guidance and education campaigns could help reduce the use of UCTs? This includes any suggestions on improvements to current guidance or areas where further guidance is needed.

Having discussed this with our own lawyer, Dr Franci Cantatore, Associate Professor of Law at Bond University and who provides training clinics for students that want to practice law, both of us are in agreement that the issue starts firmly with the lawyers. Based on what we've seen, most lawyers create contracts based on precedents. That is a big issue for junior lawyers, particularly for the bigger law firms as these contracts are rarely, if ever, updated to cope with changes in the law or the application of amendments. That allows for terms and condition clauses that are now regarded as UCT's to persist.

Therefore, there must be a demand from the regulators for the legal profession to bring their contracts up-to-date with the UCT changes as soon as possible. In doing so, though, the contract has to remain commercially realistic. With the high cost of contesting UCTs in the Courts, parties cannot be either risk-averse or risk-tolerant to UCTs; there needs to be a middle ground.

In our opinion, there has been no or very little spent in educating businesses to be compliant with UCTs. For example, there has been no media advertising reminding industry of what a UCT is. In our view, regulators cannot and should not rely on the few big cases they take and then hope the lawyers circulate the details to their clients. Many small businesses simply do not have a lawyer so word is never going to go down far enough. State regulators could possibly assist in this regard but equally, they have been remiss themselves as we are unaware of any prosecution they have taken.

Discussion Question 6

Do you consider making UCTs illegal and introducing financial penalties for breaches would strengthen the deterrence for businesses not to use UCTs in standard form contracts? Please provide reasons for your response.

Given we have stated that many parties to a contract are apathetic or believe they have no ability to negotiate alternative contract terms, then a UCT in a standard form contract should be considered illegal and may be subject to a civil penalty provision by a Court. Where

contract terms have been freely negotiated and amended, however slight, then the UCT provisions should not apply.

Flexible remedies

Discussion Question 11

Do you consider a regulator should be able to commence court proceedings on behalf of a class of small businesses on the basis that an unfair term has caused or is likely to cause the class of small businesses to suffer loss or damage? Please detail reasons for your position, including the possible impact this might have on your business.

Yes. The provision already exists for ASIC to act on this basis under the National Consumer Credit Protection Act 2009 (Cth). It would have no effect for our members and clients.

For Min-It Software, as a small business ourselves, that supplies the standard term contracts used by our clients for free as part of our services in a highly regulated market, we updated our contracts back in 2016 before the review had even finished. As part of what we do, if there any legislative changes affecting either us or our clients, we review the relevant documents and apply the changes immediately as we cannot afford any reputational damage. We try to be leaders rather than followers. Consequently, we believe there would little impact for us but acknowledge the vast majority of businesses do not act like we do.

Definition of a small business

Discussion Question 12

What impact has the current headcount threshold had on your business (or those businesses you represent)? Please include any relevant information including, costs, benefits, impact on business practices, etc.

We are aware of only one party that has provided information on its use of the current headcount threshold. At the time of the contract creation, only the lender was the small business. The other party, however, had shrunk in size and so argued it should be treated as a small business and entitled to the UCT provisions applying to small businesses. There is still some protracted argument on this but the issue has been referred to mediation. At this stage, we are unaware of the outcome. We cannot tell whether there have been or how many others there may have been.

Discussion Question 13

If the headcount threshold were to be increased, how might this impact your business? Include any estimates of potential costs and savings.

There would be no savings at all but we would be against increasing the headcount. Our members and clients have indicated there would be no savings or additional costs either.

Discussion Question 14

If annual turnover was used to determine whether a business should be covered by the UCT protections for small business, what impact might this have on your business?

None at all on either Min-It Software or our members and clients.

Discussion Question 15

Do you consider \$10 million annual turnover to be an appropriate threshold? Please detail reasons for your position, including the impact this might have on your business.

Applying a one size fits all approach creates a problem with any definition of a small business. This approach always excludes some businesses that probably should be deemed as such.

As a generalisation, our members and clients are of the opinion a \$10 million turnover threshold is way too high. Notwithstanding this figure came out of the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Financial Services Royal Commission), this is based on the premise any business generating almost \$200,000 a week is not a small business. Typically, they regard the \$5 million threshold as also being too high. However, this view is primarily based on applying what would be reasonable margins to the cost of goods. For franchisees supplying petrol, for example, where the turnover is high but the margin on the product is arguably low, a \$10 million threshold may still not be sufficient to cover them. In our opinion, these are not typical small businesses.

We are of the opinion the headcount plus net profitability is probably a better guide for these bigger turnover businesses with low margin. However, it is fraught with the likely prospect of an accountant's taxation reduction handling, and so unless some methodology could be arrived at that circumvents this, we believe it's ultimately impractical.

Discussion Question 16

If the annual turnover threshold were to be adopted, how might this impact your business? Include any estimates of potential costs and savings.

No known impact has been conveyed to us by either members or clients. They believe there would be no potential costs or savings for them.

Discussion Question 17

In terms of determining which businesses should be covered by the UCT protections for small business, how should employee numbers for subsidiaries be counted? Please outline reasons for these views, including the potential impact on your business.

We believe they should be counted into the headcount of the group. Whilst there is likely to be little if any impact on our members and clients, we are opposed to using artificial means to reduce a headcount so as to qualify. Most of the businesses structured this way are big enough and have sufficient capital to properly negotiate terms.

Value threshold

Discussion Question 20

Are there likely to be any negative impacts if the current contract value threshold were to be increased to \$5 million? Please provide details.

We can think of none but would argue even a \$5 million turnover threshold is still too high for the vast majority of small businesses. However, see also our response to Question 12.

Discussion Question 21

Are there likely to be any negative impacts if the contract value threshold were to be removed completely? Please provide details.

Our members and clients are opposed to removing the contract value threshold as a matter of principle. They have indicated that in doing so, the Australian Financial Complaints Authority (“AFCA”) may be inclined to change its current jurisdiction rules so that it could consider all ‘complaints’ in regard to UCTs for licenced credit providers and lessors and try to force some remediation.

Clarity on standard form contracts

Discussion Question 22

What impact do you consider 'repeat usage' would have on clarity around standard form contracts? Please outline reasons for these views.

Our members and clients indicate they would have no objection to applying repeat usage as a factor to determine a standard contract as it will allow the party to produce other similar contracts. If there are other contracts that have had similar amendments made to them over the standard offering, then it will highlight the fact succinctly that there has been some form of negotiation and it is not standard form contract.

Discussion Question 23

If the law were to be amended to set out the types of actions which do not constitute an 'effective opportunity to negotiate', what impact could this have on your business?

None for Min-It Software and relatively little on our members and clients.

One large lender client, however, has commented that if the types of actions listed are to be disregarded as forms of negotiation, given the high cost of having solicitors amend the contracts, it will only offer a standard form contract and not allow any amendments. This is likely to have some detrimental effect on the other party, particularly in regard to interest rates and fees. At the end of the day, "there ain't no such thing as a free lunch" and any increased risk will be paid for by the borrower. This lender does not know whether or not this may have some negative on its business.

Discussion Question 24

In addition to the types of actions outlined in option 4, are there any other types of actions that may appear to be 'negotiation' but which you consider do not constitute 'an effective opportunity to negotiate'? What effect have these actions had on your business?

We are unsure what this question relates to as there is no Option 4 in this section, just 3. We are therefore responding to Option 3 as though it were Option 4.

In the vast majority of instances, our members and clients already use standard form contracts and so this will only affect the few that use their own contracts and have the ability to vary the terms.

Discussion Question 25

Do you have any suggestion as to how regulators could better promote and enhance guidance on what constitutes a 'standard form contract'? Please provide details, including any suggestions around improvements to current guidance and areas where further guidance is needed.

When Victoria legislated to prohibit unfair contract terms, it produced and published guidelines on what constituted a UCT and what a standard form contract consisted of. It's been expanded a little since and our members and clients have no issue with the current list as shown on page 36 of the Consultation Paper.

We are concerned, though, at any move to focus on what constitutes negotiation and "whether an effective opportunity to negotiate has been given". Treasury notes "[t]his is especially the case where the parties have negotiated or amended one or two minor contractual terms". These are businesses and the owners should not be in business if they want to act like employees. We are totally in agreement with the consideration "that one-off and limited instances of consultation, negotiation or amendment should satisfy 'an effective opportunity to negotiate'." Most lawyers are of the same opinion and we are therefore of the view the status quo should remain.

Minimum standards

Discussion Question 26

If minimum standards under state and territory laws could be challenged as being unfair, what impact is this likely to have on your business (or those businesses you represent)?

The exclusion of terms that define the main subject matter essentially replicates Australian Consumer Law requirements in ensuring that a party cannot challenge a term concerning the basis for the existence of the contract. Primarily, this would be in regard to price, quantity or quality but it may affect other terms within the contract. Obviously, marine salvage, the

carriage of goods by ship or the constitution of a company, managed investment schemes or similar bodies are exceptions to this.

Whilst it does not affect our members or clients, on the face of it, it would appear there is good reason to accept the SCCA argument that State or Territory-imposed minimum standards should be exempted from the UCT regime.